



**STATE OF NEW JERSEY
Board of Public Utilities
Two Gateway Center
Newark, NJ 07102**

AUDITS

IN THE MATTER OF THE AUDITS OF THE)
COMPETITIVE SERVICES OFFERINGS OF)
NEW JERSEY'S ELECTRIC AND GAS)
UTILITIES PURSUANT TO THE ELECTRIC)
DISCOUNT AND ENERGY COMPETITION)
ACT, N.J.S.A. 48:3-55, 48:3-56 AND)
48:3-58)

ORDER
Docket Nos. AA00040232, EA00040233,
EA00040234, EA00040235,
EA00040236, GA00040237,
GA00040238, GA00040239

(SERVICE LIST ATTACHED)

BY THE BOARD:

On April 19, 2000, the Board authorized Staff to issue a Request For Proposal to independent consultant firms to perform audits of the competitive services offerings of New Jersey's seven electric and gas distribution companies ("utilities"), pursuant to N.J.S.A. 48:3-55, 48:3-56 and 48:3-58. The primary scope of these audits was to review the utilities' competitive services offerings so as to determine whether the utilities have complied with the Electric Discount and Energy Competition Act (the "Act"), N.J.S.A. 48:3-49 et seq., and the Board's rules, regulations and Orders related to competitive services.

The Auditors were to offer their expert opinion, based on an appropriate methodology, as to whether there was strict separation and allocation of each utility's revenues, costs, assets, risks, and functions between the utility's electric and/or gas distribution operations and its related competitive business segments ("RCBS"). The audits were also to determine: (1) whether there was cross-subsidization between utility and non-utility segments within a public utility or holding company; (2) whether the separation of utility and non-utility organizations is reasonable based upon the Board's affiliate relation and fair competition standards ("the Standards"), codified as N.J.A.C. 14:4-5 ; (3) the effect on ratepayers of the use of utility assets in the provision of non-safety related competitive services; (4) the effect on utility workers; and (5) the effect of utility practices on the market for such services. The Auditors were also asked to give their opinion on whether any other service offered by the utilities is a competitive service and to quantify, if possible, any inappropriate cost allocations between a utility and an RCBS. Following submission of proposals in response to the Request for Proposal and evaluation and review of the proposals by Board staff, on July 6, 2000 the Board selected the combined firms of Northstar, Vantage, and Mitchell Titus ("Vantage") to perform the competitive service audit of

Public Service Electric and Gas Company ("PSE&G") which is both a gas and electric utility; the combined firms of PMC Management Consultants and Warinner, Gesinger & Associates ("PMC") to perform the competitive services audits of the three electric utilities, Atlantic City Electric Company, d/b/a Conectiv Power Delivery ("Conectiv"), Jersey Central Power and Light Company, d/b/a GPU Energy ("GPUE") and Rockland Electric Company ("RECO"); and Schumaker & Company, Inc. ("Schumaker") to perform the competitive services audits of the three gas utilities, Elizabethtown Gas Company ("Elizabethtown"), New Jersey Natural Gas Company ("NJNG"), and South Jersey Gas Company ("South Jersey").

The various audits, performed under the supervision of the Board's Division of Audits, commenced on July 10, 2000 and were completed on October 16, 2000, at which time the audit results (the "Audit Reports") were submitted to the Board. By Order dated October 27, 2000, the Board acknowledged receipt, for filing purposes only, of the Competitive Services Audit Reports in their entirety, and directed that any utility or any other party wishing to contest the methodology or findings of the audits, or to otherwise comment on the audit results, file comments and/or motions to intervene with the Board Secretary on or before November 15, 2000.

The Board received comments on the Audit Reports from all seven utilities. Four parties submitted motions to intervene by the deadline. Shell Energy Services Company, L.L.C. ("Shell") moved to intervene in proceedings relating to GPUE, PSE&G and Elizabethtown. Mid-Atlantic Power Supply Association ("MAPSA") moved to intervene in proceedings relating to all the utilities; Independent Energy Producers of New Jersey ("IEPNJ") moved to intervene with respect to Conectiv and PSE&G; and the New Power Company ("New Power") moved to intervene in the NJNG proceeding.

Additionally, a motion was filed for the pro hac vice admission of Paul Forshay, Esq., to appear on behalf of Shell. The Board is satisfied that the requirements of N.J.A.C. 1:1-5.2 and R. 1:21-2 for pro hac vice admission have been met and the motion is hereby GRANTED subject to the following conditions. Mr. Forshay shall:

- (a) Abide by all New Jersey Court Rules, including all disciplinary rules;
- (b) Consent to the appointment of the Clerk of the Supreme Court as agent upon whom service of process may be made for all actions against him or his firm that may arise out of his participation in this matter;
- (c) Notify the Board immediately of any matter affecting his standing at the bar of any court; and
- (d) Have all pleadings, briefs and other papers filed with the Board signed by an attorney of record authorized to practice law in this State, who shall be held responsible for them and for the conduct of this cause and of the admitted attorney herein.

In addition, the granting of admission pro hac vice shall not become effective until proof of compliance with R. 1:20-1(b) and R. 1:28-2, which requires one payment check to be sent to the Lawyers' Fund for Client Protection for payment of the sums required by R. 1:28-2 for the lawyers' Fund for Client Protection and R.1:28-1(b) for the Ethics Financial Committee, has been filed with the Board.

Two of the parties seeking to intervene, Shell and IEPNJ, also submitted comments on the reports. Shell acknowledged that the utilities had made good faith efforts to comply with the

interim affiliate standards, but contended that, based on the auditors' findings, the Board should clarify the scope of the standards, citing in particular the conclusions of the PSE&G Report and that of Elizabethtown concerning the utilities' interpretations of the term "retail customers" in N.J.A.C. 14:4-5.1(a)(1) and the scope of N.J.A.C. 14:4-5.6. Shell urged the Board to accept the Audit Report recommendations concerning the need for Board approval prior to providing competitive services, avoiding inappropriate marketing and shared services arrangements and ensuring that cost allocation procedures are precise. Shell also suggested that the Board require that each utility employ an internal compliance ombudsman to monitor compliance with the Standards. IEPNJ withdrew its motion to intervene in the PSE&G proceeding on March 8, 2001, but maintained its motion to be included in the Conectiv proceeding. IEPNJ urged the Board to order Conectiv to provide all data not provided to the Auditor, so that its level of compliance with the Standards can be determined, particularly with respect to related competitive business segments of the Conectiv holding company. No responses to the comments were received from the utilities nor were the motions to intervene opposed.

The Division of the Ratepayer Advocate ("RPA") did not file comments, but rather filed a letter on November 9, 2000, stating that insufficient time had been allowed for meaningful comments on the seven reports, and asked for clarification of the October 27, 2000 Order with respect to further proceedings on the issues raised by the Reports. The RPA asked that the Board: (1) confirm that the Audit Reports will be considered within the context of the hearing process required under N.J.S.A. 48:3-55(k) and N.J.S.A. 48:3-58(q); and (2) establish a procedural schedule for the conduct of the hearings, including affording the RPA and other parties the right and ability to engage in discovery, to submit written testimony and to cross-examine witnesses.

GPUE responded to the RPA filing, stating that it did not object to the extension of time for comments on the reports, but disagreed with the RPA's interpretation of the Act as mandating hearings and the opportunity for discovery on the audit results. Shell also responded, agreeing that the period for comments was brief. The RPA replied to the GPUE response, stating that it was not seeking hearings pursuant to N.J.S.A. 48:3-56(f)(3) and -58(k)(3) on the audit reports themselves, but was seeking clarification of the procedures to be followed in implementing N.J.S.A. 48:3-55(k) and 58(q).

In response to the comments submitted by the gas utilities which had been audited by Schumacher, Dennis Schumacher, Executive Vice President of Schumacher, submitted a letter to the Board on December 19, 2000, agreeing with the gas utilities that sections 3 through 5 of the Standards (N.J.A.C. 14:4-5.3, 5.4 and 5.5) did not apply to certain of their affiliates because these affiliates did not provide services to retail customers in New Jersey. Schumacher noted, however, that the activities of these affiliates did need to be reviewed so as to be assured that they were not engaged in providing competitive services to retail New Jersey customers and that there was no improper cross-subsidization involving these companies. At its December 20, 2000 meeting the Board directed that a copy of this letter be sent to all those who received or purchased copies of the Schumacher reports. All parties or interveners were given until January 10, 2001 to file comments on these modifications, and comments were received from Elizabethtown, NJNG and PSE&G, agreeing with the conclusions of the Schumacher letter.

The Board has carefully reviewed the Audit Reports and the comments received and HEREBY ADOPTS the Reports, with the exceptions noted below, and ORDERS that the utilities timely undertake the recommended steps set out in the Reports that are listed below, under the direction of the Division of Audits, so as to assure compliance with the Act and the Standards. The Board is not adopting five recommendations from the Schumacher Reports, and is not ordering implementation at this time of certain recommendations in the Reports for Elizabethtown, NJNG, Conectiv and GPUE. These are the recommendations that the utilities

contested in their filed comments. The Board has DETERMINED that the issues raised by the Reports in making these recommendations should be addressed in the proceedings to adopt the final standards, and will be addressed in the next round of audits, which pursuant to N.J.S.A. 48: 3-56 (f)(2) and N.J.S.A. 48: 3-58 (k)(2) will be initiated later this year.

The following briefly summarizes the findings and comments on the seven competitive services Audit Reports, and addresses the utilities' disagreements with certain of the actions recommended by the Auditors, and lists the recommendations that are either not adopted or will not be implemented at this time.

PSE&G

Vantage found that PSE&G has made substantial progress in its overall effort to comply with the Standards, but that its efforts have been compromised by the company's interpreting the Standards in a narrow manner. Specifically, Vantage found that PSE&G's appliance service business is basically in compliance (but with specific, significant exceptions) and is not subsidized by the regulated business lines, but that Sunburst Customer Solutions, a provider of third-party meter reading, billing, and payment-center services, has never received approval from this Board to conduct activities which Vantage suggests require such approval. Vantage also found that PSEG Power has been fully and properly spun off as an unregulated subsidiary of Public Service Enterprise Group, ("PSEG") PSE&G's parent corporation, and that SERVCO, now a division of PSEG Power, is not conducting activities which are in violation of the Standards, as defined by PSE&G, but should henceforth exercise more pro-active care so as not to drift into some regulated activities. Vantage developed 24 recommendations in the PSE&G Report and PSE&G, although disagreeing with certain of Vantage's findings, has not specifically objected to implementation of these 24 recommendations. After review of the Report and comments the Board concurs with the Vantage on the need to implement its 24 recommendations and so ORDERS.

With respect to Vantage's overall conclusion that PSE&G has interpreted the Standards and used definitions in a manner to minimize the areas where the Standards apply to the company, PSE&G has responded by reiterating its definition of "retail", as used in N.J.A.C. 14:4-5.1(a)(1), as "sales made in quantities to ultimate consumers to meet personal needs, rather than for industrial or commercial uses of the article sold," and alleging that its interpretation of the scope of the Standards is consistent with the intent of the Act. To assist in the determination of this issue, the Board ORDERS that PSE&G submit, in accord with the schedule set out below, a full description of any and all competitive services offered by PSE&G and its affiliates and by PSEG and its affiliates, and claimed by PSE&G to be "wholesale," rather than "retail," together with a brief supporting its position concerning classification of these activities as "wholesale." PSE&G should also include a full explanation of its position that the standards of conduct set out in N.J.A.C. 14:4-5.6 should not apply to all the RCBSs of PSE&G as well as the transactions, interactions and relations between PSE&G and its RCBSs, as set out in N.J.A.C. 14:4-5.1(a)(2), which is not limited to RCBSs offering competitive services to retail customers.

RECO

The RECO corporate organization and that of Orange and Rockland Utilities, Inc. ("O&R"), its parent corporation, include no RCBSs. Based on its review of RECO, PMC developed one recommendation regarding verification of employee understanding of information disclosure rules. RECO has not objected to implementation of this recommendation. Upon review of the Audit Report, and RECO's response, the Board concurs with this recommendation and ORDERS that it be implemented.

CONECTIV

Atlantic City Electric Company now does business as Conectiv Power Delivery, thus utilizing the name of its parent corporation, Conectiv, Inc., as do all of the latter's affiliates. According to PMC, this situation blurs the intent of the Standards in the areas of the utility's name recognition, one of three major issues identified by PMC regarding Conectiv. The second issue is the lack of response to data requests concerning certain transactions with holding company affiliates. The third issue is that meter reading, identified by PMC as a competitive business service, is performed by Millennium Account Services ("Millennium"), a subsidiary of Conectiv Solutions, Inc., that is operating as an outside contractor rather than an RCBS of Conectiv, although it has many of the characteristics of a Conectiv RCBS.

PMC developed nine recommendations for Conectiv. The company disagrees with two recommendations that concern Millennium, Recommendations 1.B.6 and 1.B.7. Upon review of the Audit Report and the comments, the Board ORDERS that the seven recommendations that do not concern Millennium be implemented fully.

GPUE

The issues identified by PMC at GPUE include a series of information technology issues, including modifications to the "GPU.com" web site and improvements in security. Also suggested is the need for modification of information disclosure rules as well the need for revision of certain agreements between GPUE and its affiliates in order to bring them into compliance with the Standards.

PMC developed seven recommendations for GPUE. The Company disagrees with two recommendations, III.B (1) and IV. B (2) which concern more complete separation of the GPUE website from its parent company's website, and changes in the GPUE training program, designed to assure employee compliance with the Standards. The Board has carefully reviewed the Audit Report and is of the opinion that the suggested website changes may eliminate indirect linkages between regulated and competitive services. With respect to employee training, maintaining a record that each employee has read and understood training materials concerning compliance with the standards is neither excessive nor impracticable. However, as noted before, these issues are deferred and the Board ORDERS that the five Audit Report recommendations that have been accepted by GPUE be implemented fully.

ELIZABETHTOWN

Schumacher was critical of Elizabethtown's reliance on a particular general cost allocation method, the "Three-Factor Method" (payroll, assets, and revenues) because Schumaker found it to be inadequate to fairly allocate the costs at issue. Subsequent to receipt of the Audit Report, Elizabethtown's petition seeking approval to reorganize into a holding company format was approved by the Board on February 20, 2001, and this newly approved corporate structure should enable Elizabethtown to avoid the issues identified by Schumaker.

Schumaker developed 12 recommendations for Elizabethtown in addition to those eliminated by the modifications incorporated in Schumaker's December 19, 2000 letter referenced above. The Company disagrees with seven of these recommendations. With respect to Schumaker's recommendation (III-3) that Elizabethtown be mandated to form a service company, the Board FINDS that this recommendation is beyond the scope of this proceeding and should not be implemented. With respect to five of the other recommendations, all of which address cost

allocation issues, Elizabethtown states that it is willing to investigate and evaluate alternative cost allocation methodologies, but that considerable time is required for an undertaking of this nature. The company also objects to implementation of a cost allocation audit at this time. Upon review of the other recommendations and the Report and comments received, the Board FINDS that the five recommendations agreed to by the company should be implemented and so ORDERS. As noted, implementation of recommendations III-4, VI-1, VI-2, VI-3, VI-4 and VI-7, the recommendations with which Elizabethtown disagrees, are deferred at this time.

NJNG

Schumaker states that, despite a stated philosophy to accurately allocate costs, NJNG excessively utilizes a general allocation method. Schumaker urges NJNG to formalize a new system of cost allocation through detailed analyses of opportunities for the significantly increased utilization of cost causative factors.

Schumaker developed 14 recommendations for NJNG in addition to those eliminated by the modifications set out in Schumaker's December 19, 2000 letter, referenced above. NJNG disagrees with three of the recommendations, III-2, III-4 and V-1 concerning shared officers and directors, employee transfers and website design.

NJNG maintains that the only employee transfer inconsistent with the Standards occurred before their promulgation, that its filed compliance plan already adequately addressed the issues of employee transfers and shared directors and that its website is fully compliant with the Standards disclosure requirements. The Board has carefully reviewed the NJNG comments and supporting documents and FINDS that there is no basis for ordering implementation of Recommendations III-2, III-4 and V-1. The Board notes that NJNG also indicated partial disagreement with recommendations VI-2 and VI-7 with respect to the use of timesheets by certain employees, although agreeing that a greater emphasis on positive time reporting would improve cost allocation. The Board believes that all employees performing work for affiliates while working for a utility should use positive time reporting. However, implementation of Recommendations VI-2 and VI-7 will be deferred at this time. Therefore, the Board ORDERS that the 9 recommendations that have been accepted by the company should be implemented fully.

SOUTH JERSEY

Schumaker found that there is much room for improvement in South Jersey's cost allocation methodology, while acknowledging that the company had made a significant effort to improve in the months prior to the audit. Nevertheless, Schumaker noted the need for compiling a cost allocation manual that will formally prescribe the methodology to bring South Jersey into full compliance with the Standards in this crucial area.

Schumaker developed 13 recommendations for South Jersey after the modification set by Schumaker's letter dated December 19, 2000 referenced above. The Company has objected to implementation of only one recommendation, Recommendation III-4, which would require South Jersey to set up a service company. The Board FINDS that implementation of this recommendation is beyond the scope of this proceeding, but after careful review of the Report and comments the Board concurs with Schumaker on the need to implement the other 12 recommendations and so ORDERS.

FURTHER PROCEEDINGS

The Board notes that this ORDER, adopting the findings and ordering the implementation of a majority of the recommendations of the Audit Reports is based on the record made thus far in this proceeding and is not dispositive of other issues that may be raised concerning compliance with the Standards or other questions concerning relationships of, and transactions between, the utilities and their affiliates, nor does it foreclose consideration or further review or audit of these matters.

With respect to the RPA's requests concerning hearings on the issues raised by the Audit Reports, the RPA has specified that it is not seeking hearings on the Reports themselves, and the Board notes that neither the affected utilities nor the commenters have raised substantial unresolved issues concerning the methodology and findings of the Audit Reports such as to require hearings pursuant to N.J.S.A. 48:3-56(f)(3) and N.J.S.A. 48:3-58(k)(3). Rather, the RPA is requesting clarification concerning the hearings referenced in N.J.S.A. 48:3-55(k) and 58(q), to follow completion of the audits.

In this regard the Board notes that the Act contemplates that the required periodic audits may provide the basis for a number of Board actions including Board enforcement action in an individual case where a utility has unfairly allocated costs or has committed substantial and or recurring violations of the Act and the Standards resulting in an unfair competitive advantage. These matters, if contested, would require evidentiary hearings. See e.g. N.J.S.A. 48:3-55(f)(4) and (5) and 58(k)(4) and (5). However, with respect to subsections N.J.S.A. 48:3-55(k)(1) and 55(q)(1), it is evident that legislative direction to commence a hearing process following the audits references generic issues concerning the offering of competitive services by the utilities, including the issues relative to the Board's affiliate relations and fair competition Standards. With respect to the Standards, the Act required that, pursuant to N.J.S.A. 48:3-56(f)(6), interim standards, effective for 18 months, were to be promulgated so as to assure a fair competitive environment as well as to protect ratepayers, while at the same time providing that focused competitive service audit results would be available to assist in the development of permanent standards. Because in this case both the independent Auditors and the commenters raised issues about the interpretation of the interim standards, which pursuant to N.J.S.A. 52: 14B-5.1 will be scheduled to expire on September 8, 2002, the Board has DETERMINED that briefs and/or comments from the parties indicated above, be submitted so as to assist in consideration of these issues before the interim Standards are readopted or amended. After all briefs and/or comments are received the Board will schedule any further necessary proceedings.

With respect to the four motions to intervene, the Board FINDS that they were appropriately supported pursuant to N.J.A.C. 1:1-16. While, as noted, the Board has found no substantial unresolved challenge to the findings of the Audit Reports such that would require a contested case hearing pursuant to N.J.S.A. 48:3-56(f)(3) or (4) or N.J.S.A. 48:3-58(k)(3) or 58(k)(4), the Board GRANTS these motions to the extent that Shell Energy Services, Mid-Atlantic, Power Supply Association, Independent Power Producers of New Jersey and New Power Company shall be entitled to participate fully in the submission of briefs and /or comments as set forth above.

Based upon the foregoing, the Board FINDS that the sixty three (63) recommendations that have not been contested by the utilities, as more fully described and provided in the Audit Reports should be implemented under the supervision of the Board's Staff. The Board FURTHER FINDS that the following five recommendations should not be adopted, as more fully described above: recommendation III-3 from Elizabethtown Audit Report, recommendations III-2, III-4, V-1 from the NJNG Audit Report, and recommendation III-4 from the South Jersey Audit

Report. With regard to the twelve (12) recommendations that the utilities have contested in their comments, the Board will accept further comments and/or briefs from the utilities and other parties and will consider those issues raised, along with other issues raised by the audits and comments. Also, the twelve (12) recommendations not implemented at this time may be reviewed again in the next round of audits in this matter.

It is therefore ORDERED:

1. The Utilities shall provide detailed relevant updates of the information provided in their June 2001 Compliance Reports by March 1, 2002.
2. The Utilities, under the supervision of the Division of Audits, shall prepare detailed plans for implementation of the uncontested recommendations. Board Staff shall monitor, evaluate and modify, as necessary, the implementation of the recommendations. A proposed schedule for such implementation shall be prepared and submitted by each utility by March 1, 2002.
3. PSE&G shall provide the data and brief concerning the retail/wholesale issue, as indicated above, within 15 days of this Order.
4. Responses to the PSE&G filing shall be made 15 days after the PSE&G filing.
5. Briefs and/or further comments from the utilities or the intervenors addressing the issues raised by the Audit Reports, other than those to be addressed pursuant to paragraphs 3 and 4, should be filed within 15 days from the date of this Order.
6. Replies to briefs and /or comments shall be filed within 7 days from deadline for the briefs and/or comments.

DATED: February 8, 2002

BOARD OF PUBLIC UTILITIES
BY:

(SIGNED)

JEANNE M. FOX
ACTING PRESIDENT

(SIGNED)

FREDERICK F. BUTLER
COMMISSIONER

(SIGNED)

CAROL J. MURPHY
COMMISSIONER

(SIGNED)

CONNIE O. HUGHES
COMMISSIONER

ATTEST: (SIGNED)

HENRY M. OGDEN
ACTING SECRETARY